



BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of <b>California-American Water Company</b> (U 210 W), to Decrease Revenues for Water Service in its Coronado District by (\$73,100) or (0.46%) in 2008 and Increase Revenues by \$266,200 or 1.67% in 2009 and \$260,900 or 1.61% in 2010.	A.07-01-036
Application of <b>California-American Water Company</b> (U 210 W), to Increase Revenues for Water Service in its Larkfield District by \$1,272,000 or 61.91% in 2008, \$134,300 or 3.94% in 2009 and \$129,900 or 3.67% in 2010 Under the Current Rate Design or Decrease Revenues by (\$742,200) or (36.12%) in 2008 and Increase Revenues by \$50,000 or 3.72% in 2009 and \$63,500 or 4.55% in 2010 Under the Proposed Rate Design.	A.07-01-037
Application of <b>California-American Water Company</b> (U 210 W), to Increase Revenues for Water Service in its Sacramento District by \$8,966,900 or 33.89% in 2008, \$1,905,700 or 5.36% in 2009, and \$1,860,700 or 4.97% in 2010 Under the Current Rate Design or by \$10,981,000 or 41.50% in 2008, \$1,925,900 or 5.11% in 2009 and \$1,845,600 or 4.66% in 2010 Under the Proposed Rate Design.	A.07-01-038
Application of <b>California-American Water Company</b> (U 210 W), to Increase Revenues for Water Service in its Village District by \$1,537,300 or 7.43% in 2008, \$243,400 or 1.08% in 2009, and \$232,900 or 1.02% in 2010.	A.07-01-039

**REPLY BRIEF OF THE DIVISION OF RATEPAYER ADVOCATES**

**I. INTRODUCTION**

Pursuant to Rule 13.11 of the California Public Utilities Commission's ("Commission") Rules of Practice and Procedure ("Rules"), and the schedule set by

Administrative Law Judge (“ALJ”) Rochester, the Division of Ratepayer Advocates (“DRA”) files this Reply Brief in the General Rate Case (“GRC”) of California American Water Company (“Cal Am”).

DRA’s Reply Brief is directed to arguments in Cal Am’s Opening Brief, focusing on arguments DRA did not previously address, or that require further discussion. Silence on any subject should not be interpreted as agreement or disagreement.

## **II. COST OF CAPITAL – RETURN ON EQUITY**

### **A. Leverage adder to Return on Equity not justified**

Cal Am characterizes the lack of an upward adjustment by DRA to its Return on Equity (“ROE”) based on its leveraged capital structure as “arbitrary and unreasonable.” (Cal Am Opening Brief, p. 10.) Cal Am laments the lack of a risk premium in DRA’s recommended ROE, but fails to demonstrate that the Commission has adopted such a risk premium recently. Of late, neither the Commission nor DRA have adjusted the ROE of a water utility **upwards or downwards** based on its capital structure to reflect financial risk.<sup>1</sup>

Cal Am’s management team determines the company’s capital structure. If Cal Am believes that the Commission does not properly recognize the risk associated with its capital structure Cal Am’s management team can reduce the percentage of debt in its capital structure.

### **B. DRA’s recommended ROE is reasonable**

Cal Am alleges DRA’s Cost of Capital report lacks credibility due to the presence of “errors, inaccuracies and misconceptions.” (Cal Am Opening Brief, p. 13.) Although DRA’s analysis may contain some “errors, inaccuracies and misconceptions”, DRA’s recommended ROE of 9.96% is reasonable, and consistent with the ROEs adopted in recent Commission decisions where water utility ROE was litigated. (DRA Opening Brief, p. 4.)

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<sup>1</sup> For example, in D.07-06-024, the Commission adopted the company’s requested capital structure consisting of 69% equity, yet did not adjust the company’s ROE downward. (See D.07-06-024.)

DRA's recommended ROE of 9.96% is also reasonable when compared to the twelve water utility GRCs since 2003 where ROE was settled. In those twelve GRCs, the average settled ROE was 9.96%, with the settled ROEs ranging from 9.70% to 10.15% as shown in Table 1 below. In fact, DRA's recommended ROE of 9.96% in this proceeding is significantly above the value it has recommended in nearly all the past GRCs in Table 1. (DRA recognizes that settlements may not be relied upon as precedents, and is offering this information only for comparison purposes.)

**Table 1 – Settled Return on Equity for Class A Water Utilities GRCs 2003-2007**

Decision	Utility	DRA Recommended ROE	Company Recommended ROE	Decision ROE
<b>03-05-030</b>	Valencia Water	9.72%	12.00%	9.72%
<b>03-09-021</b>	Cal Water	9.10%	11.50%	9.70%
<b>03-12-040</b>	Park Water	9.30%	11.00%	10.15%
<b>04-08-053</b>	So Cal Water	9.30%	11.75%	9.90%
<b>04-08-054</b>	San Jose Water	9.18%	11.50%	9.90%
<b>04-09-041</b>	California American	10.04%	10.70%	10.04%
<b>05-07-022</b>	Cal Water	9.61%	12.15%	10.10%
<b>05-07-044</b>	San Gabriel	9.40%	12.00%	10.10%
<b>05-09-020</b>	California American	9.40%	10.50%	9.85%
<b>06-08-017</b>	Suburban Water	9.57%	11.75%	10.00%
<b>06-11-015</b>	San Jose Water	9.65%	11.20%	10.13%
<b>07-04-046</b>	San Gabriel	9.00%	12.00%	9.90%
	<b>Average</b>	<b>9.44%</b>	<b>11.50%</b>	<b>9.96%</b>
<b>This Proceeding</b>	<b>California American</b>	<b>9.96%</b>	<b>11.50%</b>	

Lastly, DRA emphasizes that the burden of proof in this proceeding is on Cal Am. Cal Am, not DRA, has the ultimate burden of proof of as to the reasonableness of its requested ROE. As the Commission has found in other rate cases, “the burden of proof never shifts from the utility which is seeking to pass its costs of operations onto ratepayers on the basis of the reasonableness of those costs.” (Application of Pacific Gas and Electric Company, 4 CPUC 3d 315, 340, D.00-02-046 *citing* Re Pacific Bell, 27 CPUC 2d 1, 21, D.87-12-067.) Cal Am has not proved, by clear and convincing

evidence, the reasonableness of its proposed ROE, an ROE that is significantly above the industry norm and - if adopted by the Commission - would unreasonably burdens ratepayers.

### **III. SPECIAL REQUEST # 1 – INFRASTRUCTURE REPLACEMENT SURCHARGE**

Cal Am contends that ISRS provides it with the operational flexibility to complete both previously reviewed projects and emergency projects. (Cal Am Opening Brief, p. 22.) Cal Am asserts that under the current regulatory framework, if an emergency project arises, construction of previously authorized projects may be slowed or postponed until the next GRC. (Id.) However, a practical limit exists as to how much infrastructure construction can occur during a certain time period, as indicated by Cal Am’s witness. (Cal Am/Harrison, 5 RT 337.) Even if Cal Am had the flexibility it requests, Cal Am has presented no evidence that demonstrates that it could complete both the previously authorized projects and emergency projects before the next GRC.

Cal Am further alleges that DRA “may not recommend approval for ... ‘switched’ or ‘postponed’ projects, even if they were necessitated by emergencies because they were not previously reviewed.” (Cal Am Opening Brief, p. 22.) However, Cal Am has not demonstrated a specific situation where DRA has not recommended approval for a reasonable project that was necessary due to an emergency situation. DRA acknowledges that emergencies such as unexpected main breaks will occur during a rate case cycle. However, speculation about how DRA “may” respond to an emergency is an extremely tenuous ground for adopting a new ratemaking mechanism that substantially favors Cal Am and reduces oversight of its capital projects. Indeed Cal Am has cited no examples where reasonable capital project proposals have been rejected by DRA.

### **IV. SPECIAL REQUEST # 3 – RATE CONSOLIDATION**

Cal Am cites three decisions where the Commission approved settlements allowing consolidation of districts. The Commission’s Rules mandate that adoption of a settlement agreement does not constitute approval of, or precedent regarding any principle or interest in any future proceeding unless the Commission expressly provides

otherwise. (See Rules 12.5.) Therefore, the three settlements allowing the consolidation cannot be used as justification or precedent for authorizing Cal Am's request to consolidate the Larkfield and Sacramento districts.

In addition to Commission approval of the settlements not constituting precedent, the three settled cases are readily distinguishable from the case at hand. All three settlements referenced by Cal Am allowed consolidation of districts located in relatively close proximity in the Los Angeles area. The proximity of the districts made approval of the consolidation reasonable. Larkfield and Sacramento are not in the same general area. In reality, the Larkfield area has closer ties, in terms of economics and distance, to the San Francisco Bay Area than Sacramento.

In D.93-01-006 the Commission approved a settlement allowing the consolidation of Suburban Water Systems' Whittier and La Mirada districts.<sup>2</sup> However, D.93-01-006 is clearly distinguishable from the consolidation request in this proceeding. Whittier and La Mirada are only 6 miles apart whereas Larkfield and Sacramento are 120 miles apart and do not share common water sources, personnel or operating characteristics.

D.94-11-004 is also distinguishable from the case at hand.<sup>3</sup> D.94-11-004 presents a similar situation where the Commission authorized the consolidation of three non-contiguous districts in the Los Angeles Basin. Again, the Duarte, San Marino and Baldwin Hills districts are located relatively close together in Los Angeles. The distance between these three districts ranges from 10 to 30 miles, far less than the 120 separating Sacramento and Larkfield.

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<sup>2</sup> In the Matter of the Application of Suburban Water Systems (U 339-W) for an order authorizing it to combine its present separate Whittier and La Mirada Districts into a single Whittier/La Mirada District, and to increase its rates for water service in its newly formed Whittier/La Mirada District, 57 CPUC.2d 127, 1994 Cal PUC LEXIS 1093.

<sup>3</sup> In the Matter of the Application of California-American Water Company (U 210 W) for an order authorizing it to increase its rates for water service in its Duarte District; In the Matter of the Application of California-American Water Company (U 210 W) for an order authorizing it to increase its rates for water service in its BALDWIN HILLS District; In the Matter of the Application of California-American Water Company (U 210 W) for an order authorizing it to increase its rates for water service in its SAN MARINO DISTRICT, 57 CPUC.2d 127, 1994 Cal PUC LEXIS 1093.

The situation in D.96-04-076, where the Commission accepted a settlement allowing consolidation of the Whittier/La Mirada district with the San Jose Hills district is similar to that in D.93-01-006.<sup>4</sup> The San Jose Hills district is also located in the same area of Los Angeles as Whittier/La Mirada district, and is twelve miles from La Mirada and ten miles from Whittier. This consolidation also presents a very different situation from the consolidation Larkfield and Sacramento.

Lastly, the decisions approving the settlements are of no value because the decisions do not contain any language discussing the merits of those respective consolidation requests. At most, the decisions only indicate that the parties agreed upon a settlement to avoid “the expense, inconvenience, and uncertainty attendant to litigation of issues in dispute.” (1993 Cal. PUC LEXIS 6, \*2-3; 1996 Cal. PUC LEXIS 613, \*15-16; 1994 Cal PUC LEXIS 1093, \*56-57.) The decisions found the settlements “reasonable in light of the whole record, consistent with the law, and in the public interest.” (1993 Cal. PUC LEXIS 6, \*3; 1996 Cal. PUC LEXIS 613, \*15-16.) Since the decisions lack any language regarding the merits of the consolidation requests, they do not provide precedent **for or against** consolidation. The decisions simply show that Commission has approved settlements that allow consolidation.

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<sup>4</sup> In the Matter of the Application of Suburban Water Systems (U 339-W) for an order authorizing it to combine its present separate San Jose Hills and Whittier/La Mirada Districts into a single district encompassing total company operations, and to increase its rates for water service for the total company, 66 CPUC.2d 59, 1996 Cal. PUC LEXIS 613.

**V. CONCLUSION**

For all the foregoing reasons, and for the reasons set forth in its testimony, DRA respectfully requests that the Commission adopt its recommendations.

Respectfully submitted,

/s/ Marcelo Poirier

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Marcelo Poirier  
Staff Counsel

Attorney for the Division of Ratepayer  
Advocates

California Public Utilities Commission  
505 Van Ness Ave.  
San Francisco, CA 94102  
Phone: (415) 703-2913  
Fax: (415) 703-2262

July 3, 2007

**CERTIFICATE OF SERVICE**

I hereby certify that I have this day served a copy of “**REPLY BRIEF OF THE DIVISION OF RATEPAYER ADVOCATES**” in **A.07-01-036, et al.** by using the following service:

[ X ] E-Mail Service: sending the entire document as an attachment to all known parties of record who provided electronic mail addresses.

[ ] U.S. Mail Service: mailing by first-class mail with postage prepaid to all known parties of record who did not provide electronic mail addresses.

Executed in San Francisco, California, on the 3rd day of July, 2007.

/s/ Nelly Sarmiento

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Nelly Sarmiento

**N O T I C E**

Parties should notify the Process Office, Public Utilities Commission, 505 Van Ness Avenue, Room 2000, San Francisco, CA 94102, of any change of address and/or e-mail address to insure that they continue to receive documents. You must indicate the proceeding number on the service list on which your name appears.

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**Service List – A0701036, et al.**

jspurgin@toaks.org  
mpo@cpuc.ca.gov  
ldolqueist@steefel.com  
jbouler@comcast.net  
turnerkb@amwater.com  
sleeper@steefel.com  
dstephen@amwater.com

bajgrowiczjim@comcast.net  
plescure@lescure-engineers.com  
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